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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies.

Rulemaking 06-04-009
(Filed April 13, 2006)

**JOINT ADMINISTRATIVE LAW JUDGES' RULING
AND NOTICE OF PREHEARING CONFERENCE**

Today's ruling provides notice of a November 28, 2006 prehearing conference (PHC); establishes the due date for pre-PHC comments on the scope, schedule, and need for evidentiary hearings in Phase 2; and addresses other procedural matters. As described in this ruling, parties are asked to comment on whether any policies or guidelines adopted in Decision (D.) 06-02-032 should be reexamined as a result of passage of Assembly Bill (AB) 32.

I. Notice of PHC and Due Date for Pre-PHC Comments

A PHC will be held at 1:30 p.m. on Tuesday, November 28, 2006, at the Commission Hearing Room, 505 Van Ness Avenue, San Francisco, California 94102.

The purpose of the PHC will be to address Phase 2 scoping issues, scheduling, and other procedural matters, including the need for evidentiary hearings. Pre-PHC comments addressing these issues are due by November 15, 2006. In preparing their comments on the scope of Phase 2 of this rulemaking, interested parties should review the Order Instituting Rulemaking (OIR), the comments filed by parties in response to Administrative Law Judge (ALJ) Meg

Gottstein's April 17, 2006 ruling, D.06-02-032, and Attachment A to this ruling. Interested parties should also comment on the proposed schedule for Phase 2 and prioritization of issues that we have outlined in Attachment B, and indicate if there are other scheduling considerations (e.g., hearings in other proceedings) that should be considered in developing a final schedule.

II. Scope of Phase 2 of This Proceeding

The OIR presents a preliminary scoping memo that sets forth two major issue areas in this rulemaking: (1) threshold issues associated with considering the adoption and design of a greenhouse gas (GHG) performance standard, and (2) implementation issues associated with the load-based GHG emissions cap adopted in D.06-02-032 as part of the Commission's procurement incentive framework. In Phase 1 of this proceeding the Commission is addressing the threshold and implementation issues associated with a GHG emissions performance standard that may be adopted. Phase 2 of this proceeding will focus on implementation of a load-based GHG emissions cap and coordination of this Commission's regulations with regulations that the California Air Resources Board (CARB) will adopt to implement AB 32, "The California Global Solutions Warming Act of 2006," signed into law on September 27, 2006. As provided by the June 1, 2006 scoping memo for Phase 1, the Commission will also consider in Phase 2 whether a GHG emissions performance standard should be adopted as a permanent complement to a load-based GHG emissions cap and, if so, the design of such a standard.

As outlined in the OIR, the steps to implement the load-based GHG emissions cap adopted in D.06-02-032 include, but are not limited to:

- (1) quantifying the GHG emissions baseline for each Load Serving Entity (LSE),
- (2) adjusting GHG emission reduction requirements over time, relative to the baseline, (3) adopting and administering a process for allocating emission

allowances, and (4) developing flexible compliance mechanisms with appropriate performance incentives and penalties. In D.06-02-032, the Commission described that implementation of a load-based cap will be guided by the following:¹

- a. The load-based cap should include emissions allowances for “tons of carbon dioxide equivalent,” and over time include all six major GHGs (i.e., carbon dioxide, methane, nitrous oxide, hydro fluorocarbons, per fluorocarbons, and sulfur hexafluoride).
- b. The load-based cap should include provisions for lowering the GHG reduction requirements (and associated cap) over time, relative to a baseline level of GHG emissions.
- c. The baseline should be established on a historical year basis, with 1990 as the preferred reference year. A final determination on this matter should await further consideration of implementation issues associated with using this particular year as the reference, including the availability of adequate historical emissions data for the IOUs and other LSEs.
- d. The costs and benefits of the GHG emissions cap and associated flexible compliance options that are developed for Commission consideration during the implementation phase should be evaluated.
- e. GHG emissions allowances under the load-based cap should be allocated administratively by the Commission.
- f. The pros and cons of various flexible compliance options should be fully explored, including offsets, trading, banking and borrowing. Efforts during the implementation phase should focus on ensuring that compliance options are credible, verifiable, and administratively feasible.

¹ D.06-02-032, Ordering Paragraph 2.

- g. A penalty mechanism should be developed in conjunction with further consideration of flexible compliance options, with preference towards structuring penalties as alternative compliance payments.

Consistent with the Commission's direction in D.06-02-032, Phase 2 will also explore the concept of allowance sale incentives. Under this mechanism, the Commission would certify GHG emission allowances based on superior performance (as defined by the Commission) that the utilities could sell outside of California to the benefit of their shareholders.²

Passage of AB 32 changes the landscape in which the Commission will be implementing a load-based GHG emissions cap. CARB now has the lead role in implementing the provisions of AB 32, in coordination with many other agencies, including this Commission. LSEs will be expected to comply with both the Commission's load-based cap and any GHG regulations adopted by CARB to fulfill requirements in AB 32. We will be coordinating with CARB closely to define implementation plans and decision-making authority on particular issues, and indeed such coordination has already begun. We anticipate that there may be a number of issues where CARB has a lead decision-making role, but that issues explored in the context of this proceeding will be helpful toward informing the overall structure of AB 32 implementation as it relates to Commission-regulated entities. Therefore, we intend to undertake a broad investigation on issues related to the electric and natural gas sectors, even as some of the ultimate rules and regulations under AB 32 may ultimately be implemented by CARB. Integration of these two programs will be an important

² *Ibid.*, pp. 34-35, Ordering Paragraph 3.

consideration and we encourage parties to think creatively when addressing integration issues in their comments.

The policies and guidelines in D.06-02-032 were adopted prior to passage of AB 32. While Phase 2 of this OIR is designed to implement the load-based GHG emission cap adopted in D.06-02-032, coordinating and integrating the implementation with AB 32 may result in changes to the policies and guidelines the Commission adopted in D.06-02-032. Parties are placed on notice that in the course of Phase 2, the Commission may adopt policies and/or implementation rules that may modify portions of D.06-02-032 as a result of the passage of AB 32 and subsequent rulemakings by CARB. In their pre-PHC statements, parties may identify any policies or guidelines in D.06-02-032 that may require reexamination as a result of passage of AB 32. In particular, parties may address how the Commission should structure the load-based GHG emissions cap to integrate with the broader GHG emissions reduction policies being implemented by CARB.

In D.06-02-032, the Commission has articulated its intent to apply the load-based GHG emissions cap to the three major investor owned utilities (IOUs), community choice aggregators (CCAs), and energy service providers (ESPs) operating within the service territories of the three major IOUs. In its October 6, 2006 order amending the OIR, the Commission specified that, with the passage of SB 1368, it would include as respondents all ESPs, all CCAs, and all electrical corporations which include all IOUs, multi-jurisdictional utilities, and electric cooperatives. Consistent with these two decisions, Phase 2 will address whether the load-based GHG emissions cap should apply to the additional respondents added by the October 6, 2006 order amending the OIR. In their pre-PHC comments, parties should indicate if they wish an opportunity to comment

upon the Commission's authority to apply the load-based cap to all ESPs, all CCAs, and all electrical corporations in light of the passage of AB 32 and SB 1368.

In her April 17, 2006 ruling, ALJ Gottstein asked parties to comment upon a list of issues/questions to be addressed in this rulemaking that was developed by the Division of Strategic Planning (DSP). Many parties took the opportunity to address the scope of Phase 2 issues at a high level, which was understandable given the near term focus of the rulemaking at that time. DSP has updated the list of issues/questions to be addressed in Phase 2 to reflect passage of AB 32 and other changes in the regulatory landscape. Parties are invited to comment on the list in their pre-PHC comments. The updated list is presented in Attachment A to this ruling.

In both the decision adopting a load-based GHG emission cap (D.06-02-032) and the OIR, the Commission stated its intent to examine the costs and benefits of various implementation options. With passage of AB 32, the legislature and the Governor have determined that limiting GHG emissions is in the public interest. Rather than performing an analysis of the benefits of a load-based cap, we will focus in this proceeding on evaluating the cost effectiveness of different implementation options, in cooperation with CARB.

Several municipal utilities have filed comments in Phase 1 as interested parties. We appreciate these entities sharing their expertise and knowledge about the broader electricity market in California. We encourage these parties and other municipal utilities to participate in Phase 2. Municipal utilities have expertise and information about the segment of California's electricity market that is not regulated by the Commission. Municipal utilities can provide parties to this proceeding, as well as the Commission, insight about the effect that various implementation options could have on municipal utilities and the California electricity market as a whole. As stated earlier, we intend to

undertake as broad an investigation as possible in this proceeding in order to fully inform our decision-making on the load-based cap, as well as to assist CARB, where relevant and helpful, with AB 32 implementation activities.

III. Proposed Phase 2 Schedule

In the OIR, the Commission stated its goal to move forward with key implementation issues associated with the procurement incentive framework established in D.06-02-032.³ Therefore, we have developed a draft schedule that considers Commission staff resource availability as well as the work load on Respondents and interested parties, many of which will also be participating in other high-priority resource proceedings during 2007 and 2008.

It is the Commission's intention to complete this rulemaking within 24 months of the date of the Assigned Commissioner's scoping memo to be issued in Phase 2.⁴ The draft schedule for Phase 2 of this proceeding is organized around five programmatic elements: (1) reporting requirements, (2) baseline development and allowance allocation, (3) design of cap structure and ratchet, (4) flexible compliance mechanisms, and (5) modeling to support the evaluation of cost effectiveness. The issues underlying the programmatic elements are described in Attachment A. The draft schedule is contained in Attachment B.

In their pre-PHC comments, parties should discuss the sequence (phasing) and timing for addressing the implementation issues identified in Attachment A (and any additional issues that parties may identify), coordination with the CARB process, and the draft schedule in Attachment B. We are interested in

³ OIR, Section IV.

⁴ Order Amending OIR, Section IV.

parties' opinions about the priority assigned to different issues and whether the amount of time allotted for each issue reflects the relative complexity of the issues to be resolved.

In considering the proposed issues and schedule, parties should recommend an appropriate procedural process for addressing each of the programmatic areas and underlying issues. In the past, the Commission has used a variety of different procedural processes to clarify and resolve issues. In some cases, an issue is explicated through parties' comments and/or formal hearings which are followed by a draft decision. Other times, Commission staff has conducted workshops, followed by comments and then a draft decision. In some instances, Commission staff has prepared either straw proposals or white papers which formed the basis of parties' comments. Lastly, the Commission has sometimes relied upon multi-party industry working groups to prepare summaries of the issues and/or proposals that have been used as a basis for parties' comments.

For each of the five programmatic areas outlined above, parties should comment upon an appropriate procedural process and the need for evidentiary hearings.⁵ Parties should also include their extent of planned participation in each programmatic area. We realize that parties may not know the extent of their participation at this time and any answer they provide does not limit a party's participation in the future. Additional rulings will clarify the procedural process to be used for each programmatic element.

⁵ In the June 1, 2006 scoping memo for Phase 1, the categorization was reaffirmed as "quasi-legislative."

IV. Coordination with the Governor's Climate Action Team, CARB, and the Climate Action Registry

In D.06-02-032, the Commission recognized the need to work closely with the California Climate Action Registry (CCAR or Registry) and the Governor's Climate Action Team in moving forward with implementing a load-based cap.⁶ In addition, the Commission recognized that implementation of an emissions registration requirement for generation resources would require close coordination with the Registry. In discussing the development of a baseline and emissions reductions (and associated cap) over time, the Commission also stated:

"...we recognize that the CCAR is essential to this effort. We note that CCAR participated in the workshops in this proceeding by describing the emissions data collection efforts already completed and those underway. CCAR has also offered to work closely with the LSEs on the further development of emissions data and with this Commission in exploring the implementation options associated with a load-based cap.[footnote omitted.] We appreciate CCAR's constructive participation in this proceeding. We will work closely with them, as well as the Governor's Climate Action Team, in our efforts to establish baselines and associated GHG emissions caps."⁷

The need for close coordination has intensified and shifted with the passage of AB 32, as well as the Governor's issuance of Executive Order S-20-06

⁶ Executive Order S-3-05, issued by Governor Schwarzenegger on June 1, 2005, called for the California Environmental Protection Agency (CalEPA) to lead a multi-agency effort to conduct an analysis of the impacts of climate change on California and to develop strategies to achieve the targets and mitigation/adaptation plans for the state. This effort is referred to as the Climate Action Team. The Climate Action Team is currently comprised of representatives from the Governor's Office, CalEPA, this Commission, California Energy Commission (CEC), California Department of Transportation, Resources Agency, CARB, California Integrated Waste Management Board, and California Department of Food and Agriculture.

⁷ D.06-02-032, *mimeo.*, p. 40.

on October 18, 2006.⁸ In addition to the Commission's previously stated intention to coordinate closely with the Climate Action Team and the Registry, AB 32 now also codifies an independent role for CARB in the development of a statewide multi-sector approach to climate policy. Therefore, as already envisioned by D.06-02-032, the Commission will work closely and collaboratively not only with the Climate Action Team as a whole, and with the Registry on reporting issues, but also directly with CARB on the integration of the Commission's greenhouse gas emissions policies with the statewide policies and regulations under development at CARB. In developing a load-based GHG emissions cap, the Commission will also consult with the CEC and the California Independent System Operator, which have important expertise in this area. We do not anticipate that any of these organizations will participate as parties in this rulemaking but, rather, that Commission staff will coordinate regularly with their counterparts at the other agencies. In addition, we expect that decisionmakers at all involved agencies will be communicating directly to ensure a coordinated approach to policymaking and rulemaking associated with the implementation of AB 32 and Executive Order S-20-06. We fully understand and intend that some of the outcome of this proceeding may be used to help inform AB 32 implementation efforts by CARB at the statewide level, and we will work closely with CARB on the development of joint and/or coordinated policies, wherever possible.

V. Service List, Filing Requirements, Electronic Service Protocols

⁸ Executive Order S-20-06 reiterates the direction in Executive Order S-3-05 that the Secretary of CalEPA, as the leader of the Climate Action Team, should coordinate statewide policies and efforts to address climate change.

In Phase 1, a service list was established for this proceeding. It is our intention to continue using this service list. As provided for in the Commission's Rules of Practice and Procedure, we will consider requests to be added to the service list by persons attending the November 28, 2006 PHC.

All parties filing pre-PHC comments shall file the comments at the Commission's Docket Office and shall serve them pursuant to the Electronic Service Protocols attached to the OIR and consistent with Rules 1.9 and 1.10 of the Commission Rules of Practice and Procedure. The parties shall serve their comments on the service list for R.06-04-009 posted at www.cpuc.ca.gov when those comments are due, and shall mail a hard copy of the comments to the Assigned ALJs and Commissioner.

IT IS RULED that:

1. As described in this ruling, a PHC shall be held at 1:30 p.m., on Tuesday, November 28, 2006, at the Commission's Hearing Room, 505 Van Ness Avenue, San Francisco, California.
2. As directed in this ruling, parties may file pre-PHC comments addressing scoping and scheduling issues, including the need for evidentiary hearings, no later than November 15, 2006.
3. The service list for this proceeding shall be the current service list in R.06-04-009, plus those individuals that make appearances at the November 28, 2006 prehearing conference.
4. The comments required by this ruling shall be filed at the Commission's Docket Office and served pursuant to the Electronic Service Protocols attached to the OIR and consistent with Rules 1.9 and 1.10. The parties shall serve their comments on the service list for R.06-04-009 posted at www.cpuc.ca.gov when

those comments are due, and shall mail a hard copy of the comments to the Assigned ALJ and Commissioner.

5. This ruling shall be served on the service lists in this proceeding and R.04-04-003 and R.06-02-013, the procurement rulemakings. For the purpose of serving this ruling, those organizations and individuals listed under the state service list and information-only categories in the service lists above will be served electronically only.

Dated November 1, 2006, at San Francisco, California.

/s/ CHARLOTTE F. TERKEURST

Charlotte F. TerKeurst
Administrative Law Judge

/s/ JONATHAN LAKRITZ

Jonathan Lakritz
Administrative Law Judge

Attachment A

Draft Scope of Issues for Phase 2 of R.06-04-009

This ALJ ruling seeks comments on the proposed scope, schedule, and questions related to implementation issues associated with the load-based GHG emissions cap adopted in D.06-02-032. Please identify any significant issue areas not identified in the following list, as well as any significant questions not included in the list of related questions that should be addressed in Phase 2, and explain why. In addition, please state how you envision Commission activities in these areas integrating with CARB implementation activities related to AB 32. Finally, present recommendations regarding the prioritization and staging of these issues and the need for evidentiary hearing, if any.

Phase 2 Issue Areas:

- 1) Establish GHG emissions reporting standards and requirements, including treatment of GHG emissions from non-specific resource contracts. Explore with CCAR and CARB ways in which protocols may need to be modified or further developed to include generation/facility-specific data to fit within a load-based cap.
- 2) In conjunction with work in issue area #1 above:
 - (a) Establish a date by which all power purchase agreements that PG&E, SDG&E and SCE sign must include a provision requiring supplier registration or other mandatory reporting of carbon emissions, and
 - (b) Develop a method for assigning emissions values to supplies that are unregistered.
- 3) Establish the GHG emissions baseline for each LSE.
- 4) Establish GHG emission reduction requirements over time for LSEs as a whole and for each individual LSE, relative to the baseline.
- 5) Establish and administer a process for allocating emission allowances.
- 6) Evaluate and consider various flexible compliance mechanisms, including but not limited to, multi-year compliance periods, early action credits, banking provisions, in-state and out-of-state trading options, and emission offsets, among others.

- 7) Consider whether a GHG emissions performance standard should be adopted as a permanent complement to a load-based GHG emissions cap and, if so, the design of such a standard.
- 8) Evaluate the cost effectiveness of the most promising flexible compliance options. Develop appropriate scenario analysis for this purpose.
- 9) Develop appropriate performance incentives and penalties. Explore the concept of allowance sale incentives, consistent with the direction in D.06-02-032, and with AB 32 implementation.
- 10) Address how energy service providers and community choice aggregators, as well as small and multi-jurisdictional utilities, should be included under the load-based cap incentive framework. In particular, per D.06-02-032, identify where these energy service providers, community choice aggregators and utilities should be subject to the same terms and conditions of GHG reduction requirements and associated caps, and where differences may be appropriate. Address how to coordinate the Commission regulated energy sector program with one that may be contemplated for the non-Commission regulated load serving entities, such as municipal utilities.
- 11) Define the steps to take to ensure that GHG emissions associated with customer use of natural gas are incorporated into a procurement incentive framework for the future.

Specific Questions Regarding Reporting Requirements:

- a) How accurate are the LSEs' current emissions estimates, including emissions associated with imported power and non-unit-specific power contracts? What, if any, reporting or accounting improvements are needed to ensure that emissions reported reflect actual emissions associated with LSE load in order to implement a load based cap-and-trade program?
- b) What information is needed to account for the emissions characteristics of the Department of Water Resources power contracts?
- c) What information is needed to account for the emissions characteristics of liquidated damages contracts generally?

- d) What improvements should be made to improve the accuracy of LSE emissions reporting, especially as it relates to non-unit-specific power contracts?
- e) If the Commission adopts CCAR's reporting protocols, will modifications be needed to allow for facility-based registration and reporting for entities who sell power to LSEs? If so, how would facility-based reporting address entities who do not offer unit-specific contracts? What other options would provide the Commission with independently verified emissions values and estimates for LSE contracted power?
- f) What emissions information should be included in LSE procurement contracts? And how should this information be verified?
- g) In the absence of independent verification of resource-specific or contract-specific emissions values, or in order to deter inappropriate "contract shuffling," should a default emissions factor be assigned at the value of coal for any non-renewable supplies of electricity with fossil fuel emissions? Or should the emissions value be assigned at an average portfolio level such as the CEC Net System Power Average or some other level?
- h) What modifications or updates should be made to existing emission factors and estimates, if any? Are the estimates used by CCAR the best estimates available? Are they adequate to support a load-based cap? If improvements are needed, how can they be accomplished in the near term?
- i) What are the prospects for a region-wide generation attribute tracking system? What work should be done in California and, if appropriate, elsewhere to support a multi-state approach to this issue?

(END OF ATTACHMENT A)

Attachment B**Draft Schedule for Phase 2 of R.06-04-009**

The table below represents a topical outline of tasks, grouped roughly in priority and chronological order. Parties should comment on the sequencing of topics, as well as the rough time allocation presented below.

Reporting Issues	
Utilities/LSEs submit initial information about historical emissions and tracking mechanisms in place	1 st Quarter 2007
Potential workshop on “state of art” reporting requirements with CEC, the Registry, and CARB	1 st Quarter 2007
Draft Decision drafted	2 nd -3 rd Quarter 2007
Comments on Draft Decision	3 rd Quarter 2007
Baseline Development and Allowance Allocation	
Baseline methodologies and allocation proposals submitted	1 st Quarter 2007
Comments on proposals	2 nd Quarter 2007
Workshop on allocation proposals	2 nd Quarter 2007
Comments	2 nd Quarter 2007
Draft Decision drafted	3 rd Quarter-Early 4 th Quarter 2007
Comments on Draft Decision	4 th Quarter 2007
Design of Cap Structure and Ratchet	
Ruling soliciting feedback on initial proposal for cap structure and ratchet	3 rd Quarter 2007
Comments	3 rd Quarter 2007
Ruling narrowing cap structure options for modeling runs	3 rd Quarter 2007
Flexible Compliance Mechanism	
Informational workshop about flexible compliance regimes in other jurisdictions	1 st Quarter 2007
Parties file proposals for flexible compliance framework	1 st – 2 nd Quarter 2007
Comments on proposals	2 nd Quarter 2007
Ruling establishing scenarios for modeling	2 nd – 3 rd Quarter 2007

Modeling to Support Evaluation of Cost Effectiveness	
Contracting process (RFP, proposals, selection process, contract approval)	4 th Quarter 2006 – 1 st Quarter 2007
Consultants conduct public input process	1 st – 2 nd Quarter 2007
Consultants develop model	2 nd – 3 rd Quarter 2007
Workshop on model results	4 th Quarter 2007
Comments on model, outputs and need for hearing	1 st Quarter 2008
Adopt Final Policies	
Choose final scenarios/policies	1 st Quarter 2008
Decision drafted	2 nd – 3 rd Quarter 2008
Draft Decision issued via ruling for comment	Early 3 rd Quarter 2008
Workshop (if needed)	3 rd Quarter 2008
Prepare final Draft Decision	3 rd – 4 th Quarter 2008
Comments on Draft Decision	4 th Quarter 2008

(END OF ATTACHMENT B)

INFORMATION REGARDING SERVICE

I have provided notification of filing to the electronic mail addresses on the attached service list.

Upon confirmation of this document's acceptance for filing, I will cause a copy of the Notice of Availability to be served upon the service list to this proceeding by U.S. mail. The service list I will use to serve the copy of the Notice of Availability is current as of today's date.

Dated November 1, 2006, at San Francisco, California.

/s/ ELIZABETH LEWIS
Elizabeth Lewis